Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of

Amendment of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enforcement Processes

CC Docket No. 92-133

REPLY COMMENTS OF MCI TELECOMMUNICATIONS CORPORATION

MCI Telecommunications Corporation (MCI), by its undersigned attorneys, hereby submits its reply comments in the above-captioned proceeding. In these comments, as in MCI's initial comments, the focus will be on those measures which the Commission can reasonably take to simplify future rate-of-return (ROR) represcription proceedings, without unduly burdening ratepayers or otherwise infringing on ratepayers' abilities to participate fully and effectively in such proceedings.

Introduction

Among the dozens of parties submitting comments in response to the Commission's Notice of Proposed Rulemaking (NPRM), MCI was the only private-sector ratepayer party. Each of the other commenters (except for one)[1/] addressed the issues from the perspective of local exchange carriers (LECs) which will (or may, in the case of price cap LECs) be subject to the revised rules and procedures to be developed in this proceeding. As was the case in

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[1/] The General Services Administration (GSA) submitted comments on behalf of federal government agencies.

the most recent interstate ROR represcription proceeding in 1990, the LECs vastly outnumber the ratepayer parties. Unlike ratepayer parties, who must either participate in Commission ROR represcription proceedings individually or through ad hoc coalitions, the LECs have the advantage of continuous access to industry data gathered by the National Exchange Carrier Association (NECA). Similarly, the LECs can coordinate their participation in ROR represcription proceedings both through the United States Telephone Association (USTA)[2/] and through other industry bodies, both formal and informal.

As the Commission reviews the comments in this proceeding and formulates revised rules governing the ROR represcription process and enforcement procedures, it should take special care to avoid giving undue weight to the views of the LECs, who possess both numerical superiority and organizational advantages. The procedures and policies adopted in this proceeding should, instead, be carefully tailored to ensure that ratepayers will have opportunities to participate fully and fairly in the ROR represcription process. Additionally, the Commission must ensure that there will be adequate remedies for the refund of LEC overearnings, so that ratepayers will not be forced to pay rates in excess of those which are just and reasonable.

[2/] The role that USTA is able to play in coordinating LEC participation in all Commission proceedings is evidenced by the initial comments in this docket. The majority of LEC commenters either filed brief comments supporting USTA's position on one or more issues, or stated in their separate and more extensive comments that they had participated in the formulation of the USTA comments.

Discussion

MCI's review of the initial comments indicates that there are a number of issues, such as the desirability of a "semi-automatic trigger," where fairly broad agreement (if not consensus) exists. There is a second category of issues (e.g., those concerning the automatic refund rule) where the parties remain far apart. As to most of the latter group of issues, MCI anticipated the LECs' points — e.g., the bogus argument that AT&T v. FCC, 836 F.2d 1386 (D.C. Cir. 1988), precludes any automatic refund rule — and addressed them in its initial comments; MCI will therefore refrain from repeating its earlier arguments here. Instead, MCI will limit its reply comments to a relative handful of issues which, if not properly resolved, will have a substantial adverse effect on ratepayers' interests.

A. Applicability to Price Cap LECs As MCI noted in its initial comments, one of the recurring themes in the NPRM was that the simplified represcription procedures adopted in this proceeding would apply only to the LECs which remain subject to rate of return regulation. MCI suggested that the Commission's assumption that any newly-prescribed ROR would have no impact on price cap LECs was not necessarily valid.

A number of price cap LECs filed comments in response to the NPRM. For the most part, they merely echoed the Commission's statement that future represcriptions would not affect price cap carriers' sharing zones, and totally ignored the Commission's acknowledgement (also in the NPRM) that it might use different "earnings levels" under "compelling" circumstances.[3/] Others argued that the Commission had not given price cap LECs adequate

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[3/] Comments of Pacific Bell and Nevada Bell (Pacific) at 2; Comments of US WEST Communications, Inc. (US WEST) at 2.

notice that the revised procedures would apply to them, and asserted that the Commission would have to provide notice and an opportunity to comment before it could apply the revised procedures or any new ROR prescription to the price cap LECS.[4/]

MCI remains of the view that the public interest would best be served by the adoption of a single set of ROR represcription procedures and by the application of a unitary ROR to both rate-of-return LECs and price cap LECs. To the extent that the Commission believes, however, that the price cap LECs may not have been given adequate notice and opportunity to comment on this issue, MCI recommends that the Commission provide such an opportunity through the issuance of a further (or supplemental) NPRM. It is vital that the potential scope of these procedural rules be clarified before the Commission tries to apply them. Unless parties know whether the ROR to be established pursuant to these procedures will be applied only to ROR-regulated LECs or, indirectly, to price cap LECs as well, they will not know how to approach the methodological issues that must be resolved in deriving an estimate of the cost of capital — e.g., the choice of appropriate "proxies" for the access services at issue.

B. Adequacy of Notice and Comment USTA and Rochester Telephone Corporation (Rochester) claimed that paper hearings are required by statute, and that the Commission cannot lawfully substitute notice and comment procedures. These parties focus on the phrase "full opportunity for hearing" in Section 205(a) of the Communications Act, and assert that notice and comment proceedings would impermissibly shift the burden of proof to carriers in Section 205 proceedings.

[4/] See, e.g., Comments of the Bell Atlantic Telephone Companies (Bell Atlantic) at 1, n. 5.

Leaving issues of statutory construction and case law aside for the moment, MCI agrees with the Small Business Administration's (SBA's) observation that, if the Commission can remove rate-of-return regulation on some carriers through notice and comment procedures, substituting a system of price caps, (complete with baskets, bands and "sharing,") then there should be no insuperable obstacle to the prescription of a unitary ROR through similar procedures. LECs, who have actively participated in notice and comment procedures looking toward the elimination of rate-of-return regulation and its replacement with price caps and other forms of incentive regulation, now call into question the adequacy of the same procedures for the far more routine task of represcribing the ROR. This is not, at least from a policy perspective, a particularly tenable position.

In any event, the LECs' arguments fare no better when viewed from a purely legal perspective. There is nothing in the Administrative Procedure Act, the Communications Act or the Constitution that requires trial-type procedures in a rate of return proceeding. Section 205(a) authorizes prescriptions after a "full opportunity for hearing," rather than "a hearing on the record." The standards for formal rulemaking therefore do not apply to Commission ratemaking prescriptions.[5/] A "full opportunity for hearing" under Section 205(a) is provided by notice and comment procedures.[6/] Particularly where the only disputed issues center about the "economic impact" of a proposed prescription, "involving expert opinions

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[5/] Farmers Union Central Exchange, Inc. v. FERC, 734 F.2d 1486, 1523 (D.C.Cir.), cert. denied, 469 U.S. 1034 (1984).

[6/] AT&T v. FCC, 572 F.2d 17, 22 (D.C. Cir.), cert. denied, 439 U.S. 875 (1978).

and forecasts, which cannot be decisively resolved by testimony," notice and comment are enough.[7/]

C. Represcription Trigger USTA recommended adoption of a semi-automatic trigger mechanism based on a 150 basis point shift in the six-month moving average of certain utility bond yields that lasts for six consecutive months "commencing after the completion of this rulemaking." Similarly, Central Telephone Company (Centel) advocated a similar semi-automatic trigger "with initial base rates set in an order at the conclusion of this proceeding."

MCI disagrees with USTA, Centel and the other LECs who suggest that the benchmark for the trigger should be based on interest rates in effect at the conclusion of this rulemaking proceeding or even later. MCI noted in its initial comments that it is not wed to one or more particular triggers. A variety of indicators (e.g., interest rates and certain equity-based indicators) would probably be more useful than a single indicator, and a semi-automatic trigger would probably be better than an automatic trigger, in order to leave room for the exercise of judgment. No matter which indicator or indicators the Commission adopts as a trigger, the measure of those indicators in effect at the time of the 1990 represcription proceeding — the most recent proceeding — should serve as the benchmark. A trigger mechanism is meaningless if it is not tied to the most recent represcription proceeding. Only by measuring the change in interest rates (or whatever indicators are used) since the last represcription proceeding will the Commission have any guidance as to whether conditions have changed sufficiently to warrant another represcription proceeding. Using

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[7/] Id. at 22-23. See also, United States v. Florida East Coast Ry. Co., 410 U.S. 224, 245 (1973).

such a triggering mechanism, the next represcription proceeding (or the trigger proceeding, in the case of a semi-automatic trigger) should immediately be commenced whenever the triggering conditions are satisfied, whether that occurs immediately at the conclusion of this proceeding or years from now.

D. Filing Periods and Page Limits In its initial comments, MCI recommended that the Commission allow six weeks for the preparation and filing of initial and reply comments and four weeks for rebuttal, since ratepayers will need that much time. MCI also recommended that the Commission allow 50 pages for initial and reply comments and 35 pages for rebuttals (with higher page limits if supporting exhibits and affidavits are to be counted against the page limits). Rochester supported the page limits (50, 35 and 25 pages for comments, replies and rebuttals, respectively) proposed by the Commission. USTA supported the Commission's proposed page limits, but recommended grossly inadequate filing periods, with direct cases due 45 days after the issuance of the order commencing the proceeding, and responsive cases due 21 days thereafter. (USTA's real agenda becomes especially clear in light of its proposal that LECs have ten days to turn over data on which they rely to parties that request it, which would cut ratepayers' 21-day response time in half.)

The SBA suggested that, if notice and comment procedures are adopted in place of the current paper hearings, the Commission consider abandoning page limits altogether. The SBA asserted that page limits are inherently inconsistent with a key objective of notice and comment rulemaking, that of providing an opportunity for a full discussion of all relevant issues.

If page limits are to be imposed, those recommended by MCI in its initial comments

should be adopted as the absolute minimums. The SBA's recommendation of no page limits is the best solution, however, at least for reply comments and rebuttals, given that ratepayer parties will have to respond to several LECs. Moreover, the foreshortened filing deadlines advocated by USTA should not be adopted. Such deadlines would deny ratepayer parties, who generally do not possess either full-time in-house ROR experts or a stable of expert consultants on retainer, a reasonable opportunity to participate in Commission ROR represcription proceedings.

MCI also wishes to specifically disagree with the suggestion, made by some LECs (primarily those who advocate the retention of paper hearings), that only LEC parties should be permitted to file rebuttals. As explained in MCI's initial comments, LECs frequently present arguments in their replies which require a response. The rebuttal round gives the ratepayer opponent a chance to respond and, in so doing, to assist the Commission by providing a more complete and balanced record on which to base its decision.

E. Methodology There appears to be a fairly broad consensus that the Commission should not endorse or preclude any particular cost of capital methodology or methodologies in its procedural rules, but rather should permit parties to advocate whatever methodologies they believe to be appropriate. In one respect, however, the LECs appear to argue that one aspect of the cost of capital should be predetermined — namely the capital structure that is used to balance debt and equity costs. The LECs believe that the capital structure of the local exchange operating companies, rather than that of the overall holding companies, should be used.

As MCI pointed out in its comments, however, use of operating company capital structure would invite manipulation to increase the apparent cost of capital. Moreover, an exclusive focus on operating company capital structure ignores the impact that highly leveraged unregulated operations will have on the financial risk of the overall holding company, and thus on the cost of equity of the local exchange operating companies. Equity investors must invest in the entire holding company, not just in the local exchange company, and anything that affects the financial risk of the holding company must therefore be taken into account in estimating the cost of equity of interstate access services. Accordingly, if the Commission does not follow MCI's recommendation to use the capital structure of the holding companies, it might be preferable not to codify the capital structure in the regulations at all, but, rather, to allow parties to advocate in future represcription proceedings the appropriate capital structure or capital structure methodology to be used.

Conclusion

MCI reiterates its support for the Commission's efforts to simplify its LEC ROR represcription procedures. However, the Commission should take special care to ensure that its simplification efforts do not eliminate procedural guarantees that enable ratepayers to overcome the tremendous advantages enjoyed by the LECs in ROR represcription proceedings. Accordingly, MCI respectfully requests that the Commission adopt revised ROR represcription procedures consistent with the recommendations set forth herein and in MCI's initial comments.

Respectfully submitted,

MCI TELECOMMUNICATIONS CORPORATION

By: 

Larry A. Blosser
Frank W. Krogh
Donald J. Elardo
1801 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 887-2727

Its Attorneys

Dated: October 13, 1992

CERTIFICATE OF SERVICE

I, Vernell V. Garey, hereby certify that copies of the foregoing "REPLY COMMENTS," in CC Docket No. 92-133, were served by first-class mail, postage prepaid, unless otherwise noted, this 13th day of October, 1992 on the persons listed below:

Gene Kimmelman
Consumer Federation of America
1424 16th Street, N.W.
Suite 604
Washington, D.C. 20036

Brian R. Moir
Fisher, Wayland, Cooper & Leader
1255 23rd Street, N.W.
Washington, D.C. 20037-1125

Floyd S. Keene
JaAnne G. Bloom
Michael S. Pabian
Ameritech Services, Inc.
2000 W. Ameritech Center Drive
Hoffman Estates, IL 60196-1025

Jose R. Martinez-Ramirez
Puerto Rico Telephone Company
1100 17th Street, N.W., Suite 800
Washington, D.C. 20006-2105

Francine J. Berry
David P. Condit
American Telephone & Telegraph Co.
295 North Maple Ave.
Room 3244J1
Basking Ridge, NJ 07920

Michael J. Ettner
General Services Administration (LP)
18th & F Streets, N.W., Rm. 4002
Washington, D.C. 20405

Larry Sarjeant
US West, Inc.
1020 19th Street, N.W.
Suite 700
Washington, D.C. 20036

Werner K. Hartenberger
Leonard J. Kennedy
Dow, Lohnes & Albertson
1255 - 23rd Street, N.W.
Suite 500
Washington, D.C. 20037

Carol F. Sulkes
Central Telephone Company
8745 Higgins Road
Chicago, IL 60631

Richard A. Askoff
National Exchange Carrier Association, Inc.
100 South Jefferson Road
Whippany, NJ 07981

Charles H. Helein
Arter & Hadden
1919 Pennsylvania Ave., N.W.
Suite 400
Washington, D.C. 20006

Ward W. Wueste, Jr.
Richard McKenna
W11L15
5205 N. O'Connor Blvd.
P.O. Box 152092
Irving, TX 75015-2092

Gary L. Lieber
J. Thomas Esslinger
Schmelzer, Aptaker & Sheppard
2600 Virginia Ave., N.W.
Washington, D.C. 20037

Donald W. Boecke
NYNEX Washington Counsel
1828 L Street, N.W.
Tenth Floor
Washington, D.C. 20036

David R. Poe
Leboeuf, Lam, Leiby & MacRae
1333 New Hampshire Ave., N.W.
Suite 1100
Washington, D.C. 20036

David K. Hall
Bell Atlantic
1710 H Street, N.W.
Washington, D.C. 20006

William B. Barfield
M. Robert Sutherland
BellSouth Corporation
1155 Peachtree, N.E.
Suite 1800
Atlanta, GA 30367

Samuel A. Simon
Michael E. Beller
901 15th Street, N.W.
Suite 700
Washington, D.C. 20005

E. William Kobernusz
The Southern New England Telephone Company
c/o BCR Resource Center,
Suite 600
2101 L Street, N.W.
Washington, D.C. 20037

Michael Yourshaw
William B. Baker
Wiley, Rein & Fielding
1776 K Street, N.W.
Suite 1100
Washington, D.C. 20006

Lawrence H. Lovelace
Cincinnati Bell Telephone Company
201 E. Fourth Street
Suite 102-310
Cincinnati, OH 45202

John L. Barlett
Robert J. Butler
Kurt E. DeSoto
Wiley, Rein & Fielding
1776 K Street, N.W.
Washington, D.C. 20006

Timothy J. Totman
Contel Corporation
555 Thirteenth St., N.W.
Suite 480 West
Washington, D.C. 20004

Margot Smiley Humphrey
Koteen & Naftalin
1150 Connecticut Ave., N.W.
Suite 1000
Washington, D.C. 20004

James S. Blaszak
Charles C. Hunter
Gardner, Carton & Douglas
1001 Pennsylvania Ave., N.W.
Suite 750
Washington, D.C. 20036

Wayne V. Black
C. Douglas Jarrett
Keller & Heckman
1150 17th Street, N.W.
Suite 1000
Washington, D.C. 20036

Lisa M. Zaina
OPASTCO
2000 K Street, N.W.
Suite 205
Washington, D.C. 20006

Jack Shreve
Charles J. Beck
Office of the Public Counsel
c/o The Florida Legislature
111 West Madison Street
Room 812
Tallahassee, FL 32399-1400

L. Marie Guillory
Attorney for National Telephone Cooperative Association
2626 Pennsylvania Ave., N.W.
Washington, D.C. 20037

Daniel Clearfield
Denise C. Goulet
Pennsylvania Office of Consumer Advocate
1425 Strawberry Square
Harrisburg, PA 17120

Anthony M. Marquez
Colorado Office of Consumer Counsel
1580 Logan Street, #700
Denver, CO 80203

Billy Jack Gregg
Terry D. Blackwood
West Virginia Public Service Commission
700 Union Building
723 Kanawha Boulevard, East
Charleston, WV 25301

Robert K. Johnson
State of Indiana
Office of Utility Consumer Counselor
807 State Office Building
Indianapolis, IN 46204-2275

Bruce Weston
Associate Consumers' Counsel
77 South High Street
15th Floor
Columbus, OH 43215

William Page Montgomery
Susan M. Gately
Economics and Technology, Inc.
101 Tremont Street
Boston, MA 02108

David R. Conn
Alice J. Hyde
Iowa Office of Consumer Advocate
Lucas State Office Building
Des Moines, IA 50319

Penny Rubin
New York State Department of Public Service
Three Empire State Plaza
Albany, NY 12223

C. Kingsbury Ottmers
Carlos W. Higgins
Office of Public Utility Counsel
7800 Shoal Creek Boulevard
Suite 290E
Austin, TX 78757

Nancy McCabe
Central Telephone Company
1350 I Street, N.W.
Suite 500
Washington, D.C. 20006

Fred L. Sgroi
P.O. Box 11315
Kansas City, MO 64112

Douglas Brooks
Residential Utility Consumer Office
34 West Monroe
Suite 512
Phoenix, AZ 85003

Janice E. Kerr
Edward W. O'Neill
Janice Grair
California Public Utility Commission
505 Van Ness Ave.
San Francisco, CA 94102

Donald W. Gruneisen
Nicholville Telephone Co., Inc.
P.O. Box 122
Nicholville, NY 12965-0122

Andrew D. Jader
Nebraska Central Telephone Co.
P.O. Box 700
Gibbon, NE 68840

B. Earl Hester, Jr.
Lexington Telephone Co.
200 North State Street
P.O. Box 808
Lexington, NC 27293-0808

Frank M. Sahlman, Sr.
Topsham Telephone Co., Inc.
P.o. Box 1075
East Corinth, VT 05040

Carolyn C. Hill
AllTel Service Corporation
1710 Rhode Island Avenue, N.W.
Suite 1000
Washington, D.C. 20036

Charles D. Metcalf
Utelco, Inc.
827 Sixteenth Avenue
P.O. Box 88
Monroe, Wisconsin 53566-0088

Mark H. Blake
Community Service Telephone Co.
33 Main Street
Winthrop, ME 04364

Thomas P. Kerester
U.S. Small Business Administration
Office of Chief Counsel for Advocacy
Washington, D.C. 20416

Leslie A. Vial
Bell Atlantic
1710 H Street, N.W.
Wahsington, D.C. 20006

Joanne S. Bochis
National Exchange Carrier
Association
100 South Jefferson Road
Whippany, NJ 07981

James P. Tuthill
Lucille M. Mates
Pacific Bell
Nevada Bell
140 New Montgomery St., Room 1526
San Francisco, CA 94105

John N. Rose
OPASTCO
2000 K Street, N.W., Suite 205
Washington, D.C. 20006

Josephine S. Trubek
Rochester Telephone Corporation
180 South Clinton Avenue
Rochester, NY 14646

Durward D. Dupre
Richard C. Hartgrove
John Paul Walters, Jr.
Southwestern Bell Telephone
Company
1010 Pine Street, Room 2114
St. Louis, MO 63101

Marc A. Stone
Fred Williamson & Associates
2921 East 91st Street, Suite 200
Tulsa OK 74137-3300

Thomas E. Taylor
William D. Baskett III
Christopher J. Wilson
Frost & Jacobs
2500 Central Trust Center
201 East Fifth Street
Cincinnati, OH 45202

Linda D. Hershman
The Southern New England Telephone Company
227 Church Street
New Haven, CT 06506

Ray J. Riordan
Wisconsin State Telephone Association
6602 Normandy Lane
Madison, WI 53719

Martin T. McCue
United States Telephone Association
900 19th Street, N.W., Suite 800
Washington, D.C. 20006-21005

Vernell V. Garey